

Financial accounting

Topic 6: **Analysis and interpretation of financial statements - Ratio Analysis - Fund flow Analysis, cash Flow Analysis**

RATIOS AND RATIO ANALYSIS

A ratio is defined as "the indicated quotient of two mathematical expressions and as the relationship between two or more things." Here ratio means financial ratio or accounting ratio which is a mathematical expression of the relationship between accounting figures.

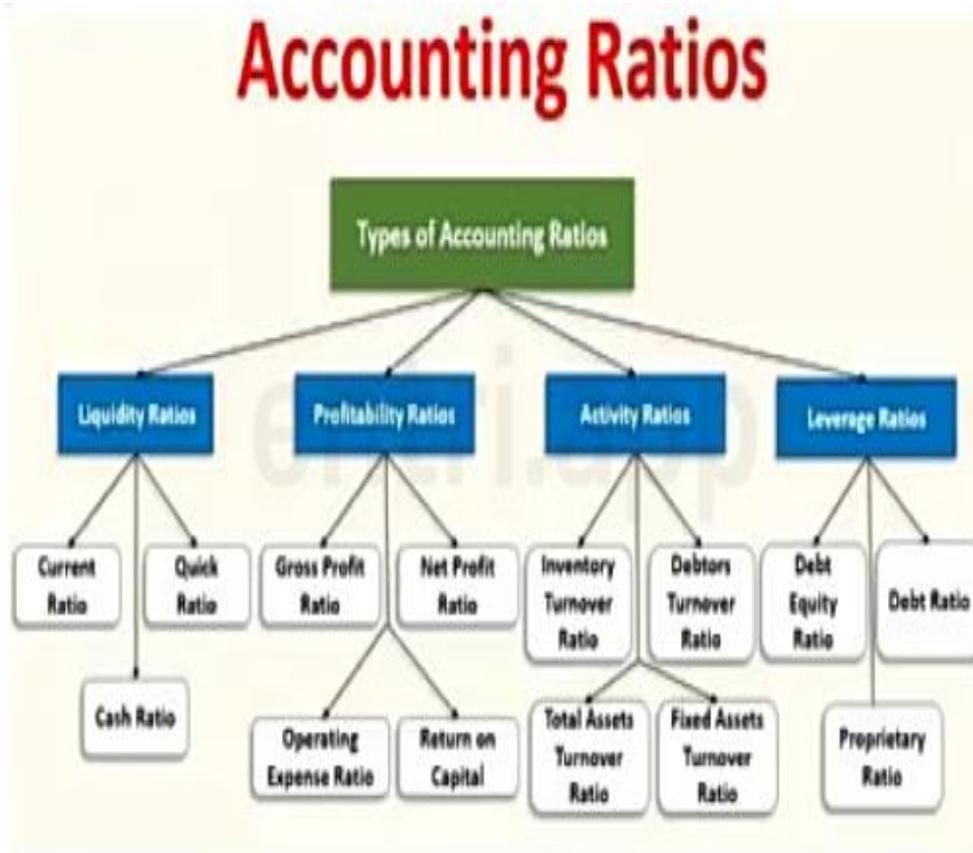
Ratio analysis is based on the fact that a single accounting figure by itself may not communicate any meaningful information but when expressed relative to some other figure, it may definitely provide some significant information.

Sources of Financial Data for Analysis

The sources of information for financial statement analysis are:

1. Annual Reports
2. Interim financial statements

- 3. Notes to Accounts
- 4. Statement of cash flows
- 5. Business periodicals.
- 6. Credit and investment advisory



service

1 Liquidity Ratios

Liquidity or short-term solvency means ability of the business to pay its short-term liabilities. Inability to pay-off short-term liabilities affects its credibility as well as its credit rating. Various Liquidity Ratios are:

1. Current Ratio

2. Quick Ratio or Acid test Ratio

3. Cash or Absolute Liquidity Ratio

4. Net Working Capital Ratio

1.1 Current Ratio

The Current Ratio is one of the best known measures of short term solvency. It is the most common measure of short-term liquidity.

The main question this ratio addresses is: "Does your business have enough current assets to meet the payment schedule of its current debts with a margin of safety for possible

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Assets = Inventories + Sundry Debtors + Cash and Bank Balances + Receivables/Accruals + Loans and Advances + Disposable Investments + Any other current assets.

Current Liabilities = Creditors for goods and services + Short term Loans + Bank Overdraft + Cash Credit + Outstanding expenses + provision for taxation + Proposed dividend + unclaimed

dividend + Any other current liabilities.

1.2 Quick Ratio

The Quick Ratio is sometimes called the "acid-test" ratio and is one of the best measures of liquidity. The Quick Ratio is a much more conservative measure of short-term liquidity than the Current Ratio.

It helps answer the question: "If all sales revenues should disappear, could my business meet its current obligations with the readily convertible quick funds on hand?"

Quick Assets = Current Assets - Inventories - Prepaid expenses


$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

1.3 Cash Ratio / Absolute Liquidity Ratio

The cash ratio measures the absolute liquidity of the business. This ratio considers only the absolute liquidity available with the firm.

$$\text{Cash Ratio} = \frac{\text{Cash and Balances} + \text{Marketable Securities}}{\text{Current Liabilities}}$$

or

$$\text{Cash Ratio} = \frac{\text{Cash and Balances} + \text{Current Investments}}{\text{Current Liabilities}}$$

1.

4 Net Working Capital

Net working capital is more a measure of cash flow than a ratio. The result of this calculation must be a positive number

Net working capital = current Assets - current Liabilities

2. Long-term Solvency Ratios /Leverage Ratios

The leverage ratios may be defined as those financial ratios which measure the long term stability and structure of the firm. These ratios indicate the mix of funds provided by owners and lenders and assure the lenders of the long term funds with regard to:

- (i) Periodic payment of interest during the period of the loan and
- (ii) Repayment of principal amount on maturity

Long-term Solvency Ratios /Leverage Ratios Leverage ratios are of two types:

1. Capital Structure Ratios

(a) Equity Ratio

(b) Debt ratio

(c) Debt to Equity Ratio

(d) Debt to Total Assets Ratio

(e) Capital Gearing Ratio

(f) Proprietary Ratio

1. coverage ratio

(a) Debt- service coverage ratio (DSCR)

(b) Interest coverage ratio

(c) Preference Dividend Coverage ratio

(d) Fixed charges coverage ratio

2.1 Capital Structure Ratios

These ratios provide an insight into the financing techniques used by a business and focus, as a consequence, on the long-term solvency position.

From the balance sheet one can get only the absolute fund employed and its sources, but only capital structure ratios show the relative weight of different sources

(a) Equity Ratio

(b) the Debt Ratio

(c) Debt to Equity Ratio

(d) Debt to Total Assets Ratio

(e) Capital Gearing Ratio

(f) Proprietary Ratio

2.1.1 Equity Ratio

This ratio indicates proportion of owners' fund to total fund invested in the business. Traditionally, it is believed that higher the proportion of owners' fund lower is the degree of

$$\text{Equity Ratio} = \frac{\text{Shareholders' Equity}}{\text{Capital Employed}}$$

risk.

Shareholders Equity = Equity share capital + Reserve and Surplus

Total Capital Employed = Shareholders Equity + Debentures + Long-Term Loan

2.1.2 Debt Ratio

This ratio is used to analyse the long-term solvency of a firm.

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Net Assets}}$$

Total Debt- Short Term and Long Term Borrowings, Debentures and Bonds

2.1.3 Debt To Equity Ratio

This ratio indicates total debt used in the business in comparison to equity. A higher ratio represents insecurity to the creditors and other lenders and the low ratio represents more safety or cushion to lenders.

$$\text{Debt to equity Ratio} = \frac{\text{Total Debt}}{\text{Shareholders Fund}}$$

Total Debt=Short Term and Long Term Borrowings, Debentures and Bonds

2.1.4 Debt to Total Assets Ratio

This ratio measures the proportion of total assets financed with debt and, therefore, the extent of financial leverage

$$\text{Debt to Total Asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Total Debt= Short Term and Long Term Borrowings, Debentures and Bonds

2.1.5 Capital Gearing Ratio

In addition to debt-equity ratio, sometimes capital gearing ratio is also calculated to show the proportion of fixed interest (dividend) bearing capital to funds belonging to equity shareholders i.e. equity funds or net worth.

$$\text{Capital Gearing ratio} = \frac{(\text{Preference Share Capital} + \text{Debentures} + \text{Other Borrowed funds})}{(\text{Equity Share Capital} + \text{Reserves} + \text{Surplus} - \text{Losses})}$$

2.1.6 Proprietary Ratio

This ratio measures the proportion of total assets financed with debt and, therefore, the extent of financial leverage

$$\text{Proprietary Ratio} = \frac{\text{Proprietary Fund}}{\text{Total Assets}}$$

Proprietary fund includes Equity Share Capital + Preference Share Capital + Reserve & Surplus. Total assets exclude fictitious assets and losses.

2.2 Coverage Ratios

The coverage ratios measure the firm's ability to service the fixed liabilities. These ratios establish the relationship between fixed claims and what is normally available out of which these claims are to be paid.

(a)Debt-Service Coverage Ratio (DSCR)

(b)Interest Coverage Ratio

(c)Preference Dividend Coverage Ratio

2.2.1 Debt Service Coverage Ratio (DSCR)

Lenders are interested in debt service coverage to judge the firm's ability to pay off current interest and instalments. Normally DSCR of 1.5 to 2 is satisfactory

$$\text{Debt Service Coverage Ratio} = \frac{\text{Earnings available for debt services}}{\text{Interest + Instalments}}$$

Earning for debt service = Net profit (Earning after taxes) + Non cash operating expenses like depreciation and other amortizations + Interest + other adjustments like loss on sale of Fixed Asset etc.

2.2.2 Interest Coverage Ratio

This ratio also known as "times interest earned ratio" indicates the firm's ability to meet interest (and other fixed charges) obligations

$$\text{Interest Coverage Ratio} = \frac{\text{Earnings before interest and taxes (EBIT)}}{\text{Interest}}$$

2.2.3 Preference Dividend Coverage Ratio

This ratio measures the ability of a firm to pay dividend on preference shares which carry a stated rate of return. This ratio indicates margin of safety available to the preference shareholders. A higher ratio is desirable from preference shareholders point of view.

$$\text{Preference Dividend Coverage Ratio} = \frac{\text{Net Profit / Earning after taxes (EAT)}}{\text{Preference dividend liability}}$$

3. Activity ratios/ Efficiency ratios/ Performance Ratios/ Turnover Ratios

These ratios are employed to evaluate the efficiency with which the firm manages and utilises its assets. For this reason, they are often called 'Asset management ratios'. These ratios usually indicate the frequency of sales with respect to its assets.

Total Assets Turnover Ratio

Capital Turnover Ratio

Current Assets Turnover Ratio

Fixed Assets Turnover Ratio

Working Capital Turnover Ratio

Inventory Turnover Ratio

Receivables Turnover Ratio

Average Collection Period

Accounts Payable Turnover Ratio

3.1 Total Asset Turnover Ratio

This ratio measures the efficiency with which the firm uses its total assets

$$\text{Total Asset Turnover Ratio} = \frac{\text{Sales / Cost of Goods Sold}}{\text{Total Assets}}$$

3.2 Fixed Asset Turnover Ratio

It measures the efficiency with which the firm uses its fixed assets.

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Sales / Cost of Goods Sold}}{\text{Fixed Assets}}$$

3.3 Capital Turnover Ratio/ Net Asset Turnover Ratio

This ratio indicates the firm's ability of generating sales/ Cost of Goods Sold per rupee of long term investment.

$$\text{Capital Turnover Ratio} = \frac{\text{Sales / Cost of Goods Sold}}{\text{Net Assets}}$$

3.4 Current Assets Turnover Ratio

It measures the efficiency using the current assets by the firm.

$$\text{Current Assets Turnover Ratio} = \frac{\text{Sales / Cost of Goods Sold}}{\text{Current Assets}}$$

3.5 Fixed Assets Turnover Ratio

It is a commonly used activity ratio that measures the efficiency with which a company uses its fixed assets to generate its sales revenue.

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Net Sales}}{\text{Average Fixed Asset}}$$

3.6 Working Capital Turnover Ratio

It represents how many times the working capital has been turned over during the period.

$$\text{Working Capital Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Net Working Capital}}$$

3.7 Inventory Turnover Ratio (ITR)

It is an activity ratio is a tool to evaluate the liquidity of inventory. It measures how many times a company has sold and replaced its inventory during a certain period of time.

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

3.8 Receivables (Debtors) Turnover Ratio

Accounts receivable turnover ratio simply measures how many times the receivables are collected during a particular period. It is a helpful tool to evaluate the liquidity of receivables.

$$\text{Receivable Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Trade Receivable}}$$

4. Profitability Ratios

The profitability ratios measure the profitability or the operational efficiency of the firm. These ratios reflect the final results of business operations. They are some of the most closely watched and widely quoted ratios

(a) Net profit (NP) ratio

(b) Gross profit (GP) ratio

(c) Expense ratio

(d) Earnings per share (EPS) ratio

4.1 Net profit (NP) ratio

It shows relationship between net profit after tax and net sales

$$\text{Net Profit (NP) Ratio} = \frac{\text{Net Profit After Tax}}{\text{Net Sales}}$$

4.2 Gross Profit Ratio

It shows relationship between gross profit and net sales

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

4.3 Expense Ratio

$$\text{Particular Expense Ratio} = \frac{\text{Particular Expense}}{\text{Net Sales}}$$

4.4 Earning Per Share

Ratio

$$\text{EPS Ratio} = \frac{\text{Net Income} - \text{Preference Dividend}}{\text{Weighted Avg No. of Shares}}$$

Fund Flow and Cash Flow Analysis

INTRODUCTION

Every company prepares its balance sheet at the end of its accounting year. It is a statement of assets and liabilities of a company as on a particular date. It shows the financial position of the company. But, it does not show the changes that have taken place between two periods. Thus balance sheet is a static statement.

Similarly, P/L A/c (Income Statement) shows only the net result (profit or loss) of the business operation during a particular period. Thus both these two statements do not explain the changes in assets, liabilities and net worth. So there is a need to analyse the Balance Sheet and Profit and Loss A/c.

For the purpose of analysis, additional statements are prepared from basic financial statements. There are two types of such statements. One is prepared on working capital basis. The other is prepared on cash basis.

The statement of changes in financial position prepared on working capital basis is known as **FUNDS FLOW STATEMENT**.

The statement of changes in financial position prepared on cash basis is known as **Cash FLOW STATEMENT**.

FUNDS FLOW STATEMENT

A Funds Flow Statement is a financial document that analyses a company's Balance Sheet of two years to validate the movement of funds from the previous financial year to the current year.

In other words, it compares the source of inflow and outflow of funds during the concerned accounting period and analyses How it affects the working capital of an organization.

A fund flow statement reveals the reasons for changes or anomalies in the financial position of a company between two balance sheets.

IMPORTANCE OF FUND FLOW STATEMENT

1. Determines the **financial consequences** of business operations. It shows how the funds were obtained and used in the past. Financial manager can take corrective actions.
2. The management can **formulate its financial policies**. dividend, reserve etc.. on the basis of this statement.
3. Serves as a **control device**, when comparing with budgeted figures. The financial manager can take remedial steps, if there is any deviation.
4. Points out **sound and weak financial position** of the enterprise.
5. Points out the **causes for changes in working capital**.
6. Enables the bankers, creditors or financial institutions in **assessing the degree of risk** involved in granting credit to the business.
7. Management can **rearrange the firm's financing more effectively** on the basis of the statement.

8. Various uses of funds can be known and after comparing them with the uses of previous years, **improvement or downfall in the firm can be assessed.**

9. The statement compared with the budget concerned will show to **what extent the resources of the firms were used** according to plan and what extent the utilization was unplanned.

10. It tells whether sources of funds are **increasing or decreasing or constant.**

LIMITATIONS

- Lacks originality because it is only rearrangement of data appearing in accounts books.
- Indicates only the past position and not future.
- Indicates fund flow only in a summary form and does not show various changes which take place continuously.
- When both the aspects of a transaction are current, they are not considered.

- When both the aspects of a transaction are non-current, even then they are not included in this statement.

FLOW OF FUNDS

The term 'flow of funds' means 'change in funds' or 'change in working capital'

It refers to movement of funds described in terms of the flow in and out of the working capital area.

In short, any increase or decrease in working capital means 'flow of funds'.

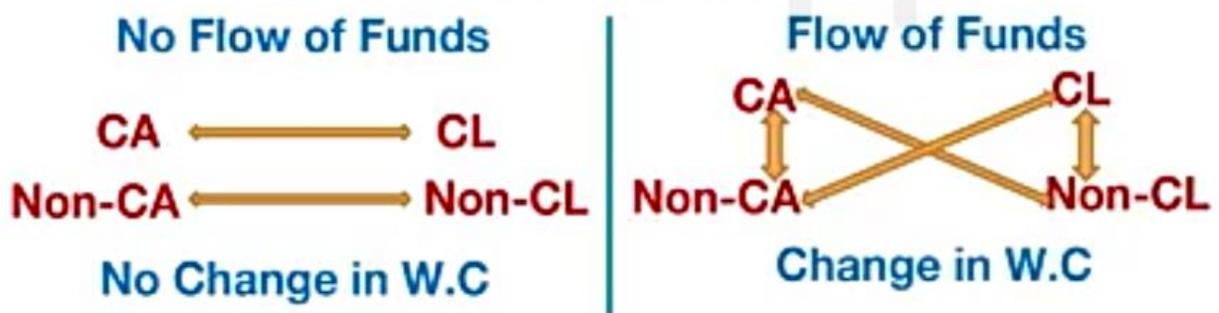
Here we can say that, when there is a change in working capital there is a flow of fund.

On what ground working capital will change?

IDENTIFICATION OF TRANSACTIONS WHICH CAUSE FLOW OF FUND

Flow fund or change working capital occurs based on the involvement of Current and Non-Current items in a Transactions.

Working Capital = Current Asset - Current Liabilities



FUND FLOW OR NOT?

Cash collected from Debtors

Purchased Goods for Cash

Payments to Creditors

Issued bills Payable to Creditors

Conversion of debentures into shares

Issue of bonus shares

Furniture purchased for cash

Issue of shares for cash

Redemption of preference shares

Issues of debentures to creditors

PREPARATION OF FUNDS FLOW STATEMENT

Step I: Prepare Statement of Changes in Working Capital

Step II: Prepare Funds from Operations

Step III: Preparation of Funds Flow Statement

Statement of Changes in Working Capital

	31/03/2019 Rs.	31/03/2020 Rs.	Increase in working capital	Decrease in working capital
Current assets				
Cash	10,000	7,000		3,000
Debtors	30,000	50,000	20,000	
Stock	35,000	25,000		10,000
	75,000	82,000		
Current liability				
Sundry creditors	40,000	44,000		4,000
Working capital	35,000	38,000	20,000	17,000
Increase in working capital	3,000			3,000
	38,000	38,000	20,000	20,000

Statement of Funds from Operations

Particular	Amount	
Net Profit After Tax for the year		xxx
Add: Non-Operating Expenses:		
Depreciation	xxx	
Loss on Sale of Fixed Assets	xxx	
Interest on Debentures	xxx	
Goodwill Written Off	xxx	
Provision for Tax	xxx	
Proposed Dividend	xxx	
Interim Dividend	xxx	
Transfer from statement of profit and loss	xxx	xxx
Less: Non-Operating Incomes:		
Interest on Investment	xxx	
Dividend Received	xxx	
Profit on Sale of Fixed Assets	xxx	
Interest on Bank Deposit	xxx	
Refund of Tax	xxx	(xxx)

Net Fund Flow From Operations

XXX

Fund Flow Statement

Sources /inflow	Rs	Applications/outflow	Rs
Funds from Operations	••	Funds lost in operations	••
Sale of fixed assets	••	Purchase of fixed assets	••
Sale of Investments	••	Purchase of investments	••
Issue of shares	••	Redemption of preference shares	••
Issue of debenture	••	Redemption of debenture	••
Loan taken	••	Loan repaid	••
Dividend Received	••	Dividend paid	••
Non-Operating income	••	Non-operating expenses	••
Decrease in working capital	••	Increase in working capital	••
	••		••

SOURCES OF FUNDS

Items to be shown under the head Sources of Funds are as follows:

1. Issue of Shares and Debentures for Cash: - The total amount received from the issue of Shares or Debentures is to shown under this head.

2. Long Term Loans: The Amount received on raising Long Term Loans is shown under this head.

3. Sale of Investments and other Fixed Assets: The Total Amount received on the sale of Investments and other Fixed Assets is to be shown under this head.

4. Funds from Operations: The Funds generated from Operations as computed in Step II are also required to be shown here.

5. Decrease in Working Capital: This would be the Balancing Figure of the Statement and will come from change in Working Capital Statement

APPLICATION OF FUNDS

1. Purchase of Fixed Assets and Investments: The Cash Payment made for purchase of Fixed Assets and Investments is an application of Funds.

2. Redemption of Debentures, Preference Shares and

Repayment of Loan:- Payment made including Premium (less: Discount) is to be taken as fund application

3. Payment of Dividend & Tax: Payment of Dividend and Tax are to be taken as applications of fund if the provisions are excluded from Current Liabilities and Current Provisions are added back to profit to determine the "Funds from Operations"

4. **Increase in Working Capital:** This would be the Balancing Figure of the Statement and will come from change in Working Capital Statement

The fund flow statement records any changes in the company's net working capital during a given period. The statement can be used to determine the financial position of a company and assists in long-term financial planning. Any irregular financial activity or expense can be detected by studying the fund flow statement.

But Cash position of an organization is not disclosed by the 'Funds Flow Statement', as a result of which a separate/additional statement, viz, '**Cash Flow Statement**' is required to be prepared to ascertain the cash position of the organization.

DIFFERENCE BETWEEN CASH FLOW AND FUND FLOW

In common dialect, cash and funds are used interchangeably. Nevertheless, when it comes to accounting, the two project significant differences in their scope and utility, among other factors.

The primary difference between the two is that **money available in physical form as a currency is termed as cash, while funds concern all the financial resources in their entirety.**

Thus, the difference between cash flow and fund flow highlights the conceptual limit of cash and a broader inclusion for funds.

CASH AND CASH EQUIVALENTS

Accounting Standard - 3 (Revised) define cash and cash equivalents as follows:

CASH

cash in hand and dem Cash comprises cash in hand and demand deposits with bank.

CASH EQUIVALENTS

These are short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value.

Cash flow	Fund flow
Cash flow refers to the concept of inflow and outflow of cash and cash equivalents during a particular period.	Fund flow refers to the concept of financial changes in working capital over a period of time.
In cash flow cash from the operations is calculated.	In fund flow fund from the operations is calculated.
Cash flow shows the position of the business in the short term position.	Fund flow shows the position of the business in the long term position.
Cash flow changes is mainly analyzed in periodic like monthly, quarterly or as required by the business.	Fund flow changes is mainly analyzed in between the previous year and the current year.
The basis of the statement in accounting is based on cash.	The basis of the statement in accounting is based on accrual.
It is a part of financial statement.	Where as fund flow is not a part of financial statement.

It is used for cash budgeting.	It is used for capital budgeting.
It has three sections i.e. Cash flow from Operating, Financing activities and Investing.	It has two sections i.e. application of fund and sources of fund.
Cash flow reporting is mandatory for companies to report as per GAAP.	Fund flow reporting is not mandatory, but can be made internally.

BENEFITS IF CASH FLOW STATEMENT

- * Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise.
- * Identifies cash generated from trading operations.
- * The operating cash surplus which can be applied for investment in fixed assets. which có
- * Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.

* Very useful tool of planning.

Statement of Cash Flows

The Statement of Cash Flows describes the cash inflows and outflows for the firm based upon three categories of activities.

Operating Activities: Generally include transactions in the "normal" operations of the firm.

Investing Activities: Cash flows resulting from purchases and sales of property, plant and equipment, or securities.

Financing Activities: Cash flows resulting from transactions with lenders and owners.

CASH FLOW STATEMENT

(A) Cash flows from operating activities	XXX
(B) Cash flows from investing activities	XXX
(C) Cash flows from financing activities	XXX
Net increase (decrease) in cash and cash equivalents (A+B+C)	XXX
+ Cash and cash equivalents at the beginning	XXX

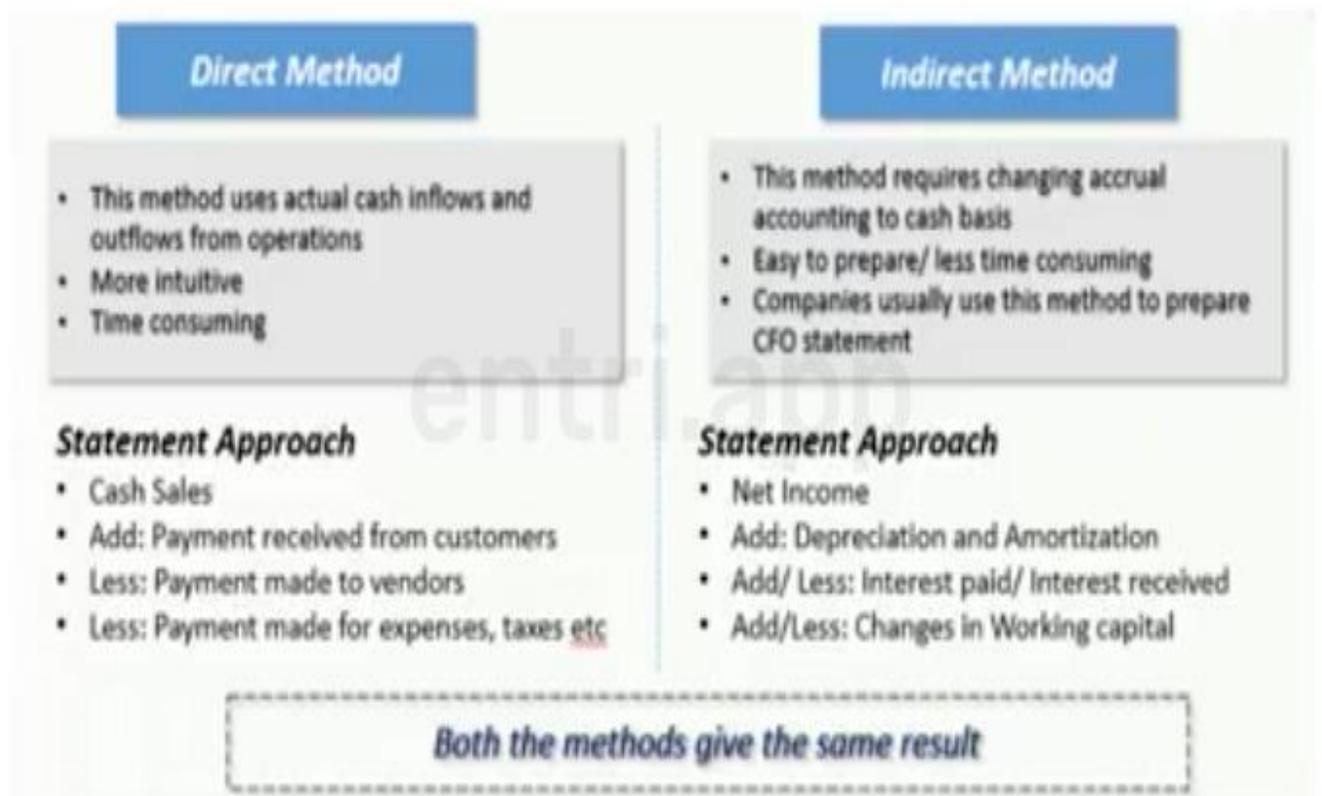
= Cash and cash equivalents at the end XXX

Operating Activities

Operating Activities include the events and transactions that determine day-to-day operating activities. These events and transactions include net income and the changes in the current asset and current liability accounts related to net income.

Those transactions and events that do not provide or use cash are excluded from determining cash flows from operating activities.

There are two methods of preparing the operating activities section:
Indirect Method and Direct Method



Cash Flows from Operating Activities (Direct Method)

Cash flows from operating activities:

Cash receipts from customers	XXXX
(-) Cash paid to suppliers and employees	(XXX)
= Cash generated from operations	XXX
(-) Income tax paid	(XXX)
items p =Cash flow before extraordinary items	XXX
+/- Extraordinary items	XXX

= Net cash from operating activities XXX

Cash Flows from Operating Activities (Indirect Method)

Net Profit/Loss before Tax and Extraordinary Items	XXX
Add: Deductions already made in Statement of Profit and Loss on account of Non-cash items such as Depreciation, Goodwill to be Written-off.	XXX
Add: Deductions already made in Statement of Profit and Loss on Account of Non-operating items such as Interest.	XXX
Less: Additions (incomes) made in Statement Profit and Loss on Account of Non-operating items such as Dividend received, Profit on sales of Fixed Assets.	<u>(XXX)</u>
Operating Profit before Working Capital changes	XXX
Add: Increase in Current liabilities	XXX
Add: Decrease in Current assets	XXX
Less: Increase in Current assets	(XXX)
Less: Decrease in Current Liabilities	<u>(XXX)</u>
Cash Flows from Operating Activities before Tax and Extraordinary Items	XXX
Less: Income Tax Paid	(XXX)
Add/Less: Effects of Extraordinary Items	<u>XXX</u>
NET CASH FROM OPERATING ACTIVITIES	<u>XXX</u>

TREATMENT OF SOME SPECIAL ITEMS

1. **Treatment of Interest:**

(a) If it is financial enterprise: Cash flows from interest paid and interest received should be treated as Cash Flows from Operating Activities.

(b) If it is other than financial enterprise: Cash flows from interest paid should be treated as Cash Flows from Financing Activities while interest received should be treated as Cash Flows from Investing Activities.

NOTE: Interest on calls-in-arrears is a cash flow from financing activities.

2. **Treatment of Dividend:**

(i) If it is a financial enterprise: Cash flows from dividend received should be treated as cash flows from Operating Activities, while cash flows from dividend paid should be treated as cash flows from Financing Activities.

(ii) If it is other than financial enterprise: Cash flows from dividend received should be treated as cash flows from Investing Activities, while cash flows from dividend paid should be treated as cash flows from Financing Activities.

NOTE: Dividend paid should always be treated in Cash Flows from Financing Activities.

3. Treatment of Taxes on Income:

- Taxes on income should be disclosed separately.
- It has also stated that it can't be identified specifically with Financing Activities or Investing Activities then, it should be classified as cash flows from Operating Activities.
- While preparing CFS current year's tax provision should be added back to the current year's profit to arrive at cash flows from operating activities.
- Tax paid during the year should be deducted from cash before tax from Operating Activities.

CASH FLOWS FROM INVESTING ACTIVITIES

- Cash flows from acquisition or disposal of long-term assets or investments are termed as Cash Flows from Investing Activities.
- The important point is to be noted here that these assets have not been held by the business concern for resale.
- In this type of classification cash flows represents the expenditure which have been made with the intention to generate future income or cash flows.

As per AS-3 (Revised) following types of activities can be regarded as cash flow from Investing Activities:

ENTRI

- Cash paid for acquiring tangible or intangible fixed assets (including those relating to capitalized R & D costs).
- Cash received from sale of fixed assets (tangibles or intangibles).
- Cash paid for acquiring shares, warrants, or debt instruments of other enterprises and/or interests in some joint ventures.
- Cash received from disposal or issue of shares, warrants, or debt instruments of other enterprises and/or interests in some joint ventures.
- Cash given as an advance and loans given to third parties.
- Cash received from the repayment of advances and losses given to third parties.

Cash Flows from Financing Activities

- Cash flows from the activities, which result in change in the shape and composition of owners' funds (including preference share capital) and borrowed funds of the business are called Cash Flows from Financing Activities.

Some of the examples of Cash Flows from Financing Activities are as follows:

- Cash receipts from issuance of share capital.
- Cash receipts from issuance of Debentures and Long term, or short-term borrowings, etc.
- Repayment of amount borrowed.
- Payment of dividend